StepToe

ORIGINAL

EX PARTE OR LATE FILED ORIGINAL

**REDACTED--FOR PUBLIC INSPECTION**

RECEIVED

SEP 23 2002

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

September 23, 2002

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW – Room TW-A325
Washington, D.C. 20554

**Re: Ex Parte Notice – Consolidated Application of EchoStar Communications Corporation, General Motors Corporation and Hughes Electronics Corporation for Authority to Transfer Control, CS Docket No. 01-348**

Dear Ms. Dortch:

In accordance with Section 1.1206 of the Commission's Rules, 47 C.F.R. §1.1206, EchoStar Communications Corporation, Hughes Electronics Corporation and General Motors Corporation, Applicants in the above-referenced merger proceeding, submit this letter to report that representatives of the Applicants met separately with Commissioner Abernathy and Legal Advisor Stacy Robinson, Legal Advisor Alexis Johns of Commissioner Copps's office, and Commissioner Martin and Legal Advisor Catherine Crutcher Bohigian on September 20, 2002. The meetings focused principally on the substantial transaction-specific benefits of the proposed merger, and the Applicants' ongoing commitment to national pricing post-merger.[1]

The Applicants outlined the significant public benefits associated with the merger, including: expansion of local-into-local service to all 210 Designated Market Areas ("DMAs"); the introduction of affordable, residential broadband services via satellite; and restraining cable prices. The Applicants' economic experts have found that the introduction of local-into-local service has lowered or restrained cable prices to the tune of $1.03 in the first year and $1.57 in the second year in the cities where it has been introduced -- a measure of the similar downward effect that expansion of local-into-local service throughout the nation will have. The Applicants's economic experts also outlined the methodology they used for simulating the merger and concluding that it will produce estimated consumer welfare benefits significantly in excess of $1 billion annually, and closer to $2 billion.

The Applicants also explained that their One Nation-One Rate Card proposal will preclude post-merger price discrimination, and will serve as a vehicle for importing competition from the urban, most heavily contested areas to consumers throughout the country. National pricing of DBS service has, and will continue to be, driven by market forces. In this connection, EchoStar has never taken advantage of an

[1] A copy of the presentation materials distributed at the meetings is attached.

No. of Copies rec'd 0+1
List ABCDE

opportunity to price discriminate in rural areas where Pegasus charges $4.50 more than EchoStar's equivalent package. Notwithstanding the $4.50 available "cushion," EchoStar maintains its uniform national pricing in these areas, in light of the benefits of national pricing.

In fact, neither the market benefits inducing operators to price their services nationally nor the effects of national pricing for competition are unknown territory to the Commission. The Commission has had occasion to observe the benefits of nationwide pricing in importing competition from the most heavily contested urban areas to rural areas throughout the nation in other industries as well. Mobile telephone services ("Commercial Mobile Radio Services" or "CMRS") are a case in point. Several parties have pointed out to the Commission that "[n]ational advertising and pricing plans also bring the benefits of robust competition to the smallest CMRS local markets, where only smaller numbers of firms may actually be offering service."[2] The point is proven by a recent study comparing prices in urban and rural areas. In the Commission's words, this study, conducted by Econ One, "found evidence of this nationwide pricing effect, in that [it] showed no differences in service costs between rural and urban markets," notwithstanding that "there are, on the average, at least two more competitors in urban markets than in rural markets."[3]

In addition, cable pricing is an area where the Commission has successfully implemented a much more complex uniform geographic pricing regime than is proposed by the Applicants here.[4] Also in recognition of the benefits of uniform pricing, the Commission in 1997 allowed cable operators to deviate from the maximum rates allowed by cable rate regulation (which diverged based on local factors) and to charge uniform prices across multiple franchise areas.[5] As the Commission pointed out, uniform pricing would be beneficial for subscribers and cable operators alike, because it would: "facilitate an operator's advertisement of a single rate for cable service over a broad geographic region, which could lower its marketing costs. . . ."[6]; "better inform consumers and enable them to compare packages of services offered by competitors, thereby improving competition among service providers";[7] and "reduce consumer confusion because a subscriber moving from one part of the operator's service area to another would not experience any difference in price or service offerings."[8] The advantages are comparable to those identified in connection with the Applicants' One Nation-One Rate Card proposal.

[2] Comments of the Cellular Telecommunications & Internet Association, WT Docket No. 01-14 (filed Apr. 13, 2001), at 18.
[3] Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, FCC 02-179, at 39 (rel. July 3, 2002). The Econ One presentation is available at http://wireless.fcc.gov/services/cmrs/presentations/FCC_2002_mahla.ppt.
[4] *See In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation*, Report and Order and Further Notice of Proposed Rulemaking, 8 FCC Rcd. 5631 (1993), at ¶¶ 423-24.
[5] *See In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation; Uniform Rate-Setting Methodology*, Report and Order, 12 FCC Rcd. 3425 (1997).
[6] *Id.* at 3426-27.
[7] *Id.*
[8] *Id.*

An original and one copy of this *ex parte* notice (and two copies of the attachment) are being filed with the Commission. If you have questions concerning this notice, please do not hesitate to contact the undersigned.

Respectfully submitted,

Gary M. Epstein /CN
Gary M. Epstein
James H. Barker
Latham & Watkins
555 11th Street, N.W.
Suite 1000
Washington, D.C. 20004
(202) 637-2200

*Counsel for Hughes Electronics Corporation and General Motors Corporation*

P. Michalopoulos /CN
Pantelis Michalopoulos
Carlos M. Nalda
Steptoe & Johnson LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 429-6494

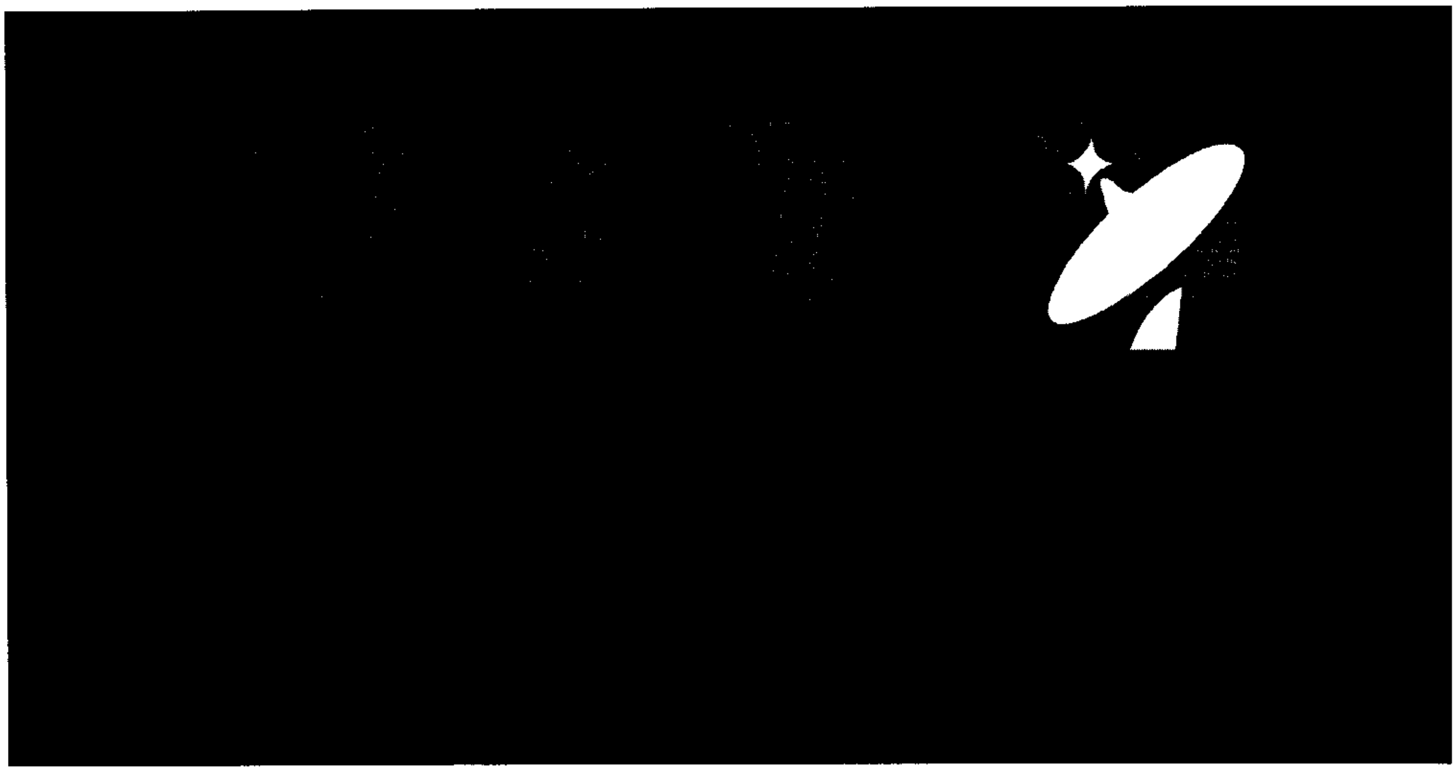
*Counsel for EchoStar Communications Corporation*

Attachment
cc (w/ att.): Commissioner Abernathy
Commissioner Martin
Stacy Robinson
Catherine Crutcher Bohigian
Alexis Johns

Presentation to the

# Federal Communications Commission

*September 20, 2002*



# Reasons for the Merger

- Free Up Scarce Spectrum, Allowing "Local-into-Local" Satellite Service to All DMAs, 12 High Definition Channels, Near Video on Demand and Other Services
- Allow the First True Residential Broadband Service by Satellite
- Create Effective Competition with Dominant Cable Providers – Curb Soaring Cable Rates
- Result in Consumer Benefits Significantly Greater than $1 Billion a Year

Only Accomplished via a Successful Merger

REDACTED – FOR PUBLIC INSPECTION

# Proceedings to Date

- Over the last 9 months we have provided a vast amount of legal, engineering and economic information in support of the merger:
  - Filings in the Merger Application Proceeding
  - Filings in the New EchoStar 1 Satellite Proceeding
  - Interrogatory Responses and Document Productions
  - Series of Seven In-Person Briefings/Meetings
  - Merger Simulation Model, Synergies Model, Local-Into-Local Models, Broadband Models

We will follow up next week with a CEO Presentation by Charlie Ergen and Eddy Hartenstein

This meeting is intended to provide an important "economic foundation" generally and for the CEO discussion

# ANALYSIS OF THE ECHOSTAR-HUGHES MERGER: COMPETITIVE EFFECTS AND NATIONAL PRICING

**Dr. Andrew Joskow**
**National Economic Research Associates**

**Dr. Robert Willig**
**Consultants in Industry Economics**

**September 20, 2002**

REDACTED – FOR PUBLIC INSPECTION

# Key Points of Analysis

- Pre-Merger State of Competition: Cable Providers Are Each DBS Firm's Closest Competitors

- Spectrum Benefits and Other Merger-Specific Efficiencies, Including Local Broadcast Stations and Residential Broadband Service to All Americans, Promote the Public Interest

- Competitive Effects Analysis: Post-Merger Economic Simulation Show Consumer Welfare Benefits Significantly In Excess of $1 Billion Annually

- National Pricing: A Post-Merger Price Increase Based on Customer Class Or Location Is Not a Plausible Outcome

REDACTED – FOR PUBLIC INSPECTION

# Key Point #1: Cable Providers Are Each Firm's Closest Competitors

[[

[ ]

REDACTED – FOR PUBLIC INSPECTION

## Key Point #1: Cable Providers Are Each Firm's Closest Competitors (continued)

- Additional data show that cable providers are each firm's closest competitors. That is, the DBS firms are primarily constrained by cable
  - *Data on New Subscribers:* [ ] of new DIRECTV subscribers are former (or current) cable subscribers, while fewer than [ ] are former EchoStar subscribers.
  - *Data on Promotions:* Promotions targeted at DIRECTV have gained EchoStar only [ ] of the subscribers gained by EchoStar promotions targeted at cable

REDACTED – FOR PUBLIC INSPECTION

# Key Point #2: Merger-Specific Efficiencies Are Significant

- The merger will generate new and expanded DBS product offerings. The key efficiencies are the freeing up of spectrum and scale economies. New EchoStar will provide:
  - All DMAs With Local-into-Local Service (instead of about 70 DMAs)
  - More High-Definition Television Channels
  - Residential Broadband Service Available to All Americans
  - More Programming Diversity (e.g., Special Interest)
  - More Pay-Per-View or Near Video-on-Demand Capability
  - More Interactive Services
- The merger will also lower marginal costs
  - Lower Programming Costs
  - Lower Hardware and Installation Costs Per New DBS Subscriber Due to Standardization and Economies of Scale

REDACTED – FOR PUBLIC INSPECTION

## Key Point #2: Merger-Specific Efficiencies Will Force Competitive Response by Cable Providers

- We find that the introduction of local-into-local service by DBS providers produces important benefits:
  - ***Subscriber Lift:*** We find that the introduction of local service by DBS has raised EchoStar's local penetration by [ ] ***percentage points*** and DIRECTV's local penetration by [ ] ***percentage points*** (after three years)
  - ***Lower Cable Prices:*** We find that the introduction of local service by DBS lowers the average expanded basic cable price by roughly ***$1.03 per month*** in the first year and ***$1.57 per month*** in the second year following introduction of local-into-local
  - ***Consumer Welfare Benefits:*** As a result of subscriber lift and lower cable prices, the merger will produce additional consumer welfare benefits of between [ ] ***per year*** from the introduction of local service in all 210 DMAs

REDACTED – FOR PUBLIC INSPECTION

## Key Point #2: Merger-Specific Efficiencies Will Force Competitive Response by Cable Providers (continued)

- DBS has forced cable providers to expand capacity/quality and HDTV product offerings
  - For example, National Cable and Telecommunications Association (NCTA) President and CEO Robert Sachs: "Being digital from the start, and having the advantage of substantially greater channel capacity, DBS spurred cable operators to replace hundreds of thousands of miles of coaxial cable with fiber optics so that they too could offer consumers hundreds of channels of digital video and audio services."
- Looking to the future, the merger may help to "jump start" the nascent market for HDTV. New EchoStar's offering of 12 (or more) HD channels will likely spur cable operators to increase their planned offerings of roughly 5 HD channels

REDACTED – FOR PUBLIC INSPECTION

# Key Point #3: Competitive Effects Analysis: Post-Merger Simulation Estimates Significant Consumer Benefits

- We use a "nested logit demand system" to simulate the impact of the merger on prices and consumer welfare
- We calibrate the model to the data on diversion between DIRECTV and EchoStar
- We include the consumer benefits resulting from subscriber lift and lower cable prices following the introduction of local service
- The two main findings of the simulation are:
  - If we incorporate the merger-specific marginal cost savings of the merger, we estimate that prices of both DBS *and* cable will fall.
  - The combination of lower DBS and cable prices – along with the introduction of local service in DMAs 71-210 – will produce <u>estimated consumer welfare benefits in excess of $1 billion</u>

## Key Point #3: Competitive Effects Analysis: Post-Merger Simulation Estimates Significant Consumer Benefits

- The estimate of consumer welfare benefits of greater than $1 billion per year is conservative and does not include other benefits:
  - Based on the parties' projections of incremental subscribers from new services, the merger simulation model suggests that an additional $663 million in consumer welfare benefits will result the introduction of additional HDTV channels, more programming diversity, a competitive broadband service, and more interactive and VOD/PPV services
  - Additional consumer benefits, which are more difficult to quantify, will likely result from cable's competitive response to New EchoStar's new product offerings. As noted above, the historical evidence suggests that cable has responded to the introduction of an improved DBS product offering (e.g., the impact of local service, HD channels, etc.)
  - Additional consumer benefits will flow from the availability to all Americans of residential broadband service

REDACTED – FOR PUBLIC INSPECTION

## Key Point #3: Competitive Effects Analysis: Post-Merger Simulation Estimates Significant Consumer Benefits

- Given the structure of the market, there is no valid concern that New EchoStar will coordinate its prices with cable providers
  - The data show that the market is too diverse for coordination: There is significant variation in expanded basic price levels *and* expanded basic price changes between cable MSOs *and* within cable MSOs (even within the same state)
- New EchoStar's incentives would be inconsistent with coordination
  - New EchoStar faces a powerful incentive to grow subscribership.
  - New EchoStar will need to attract new subscribers rapidly as digital cable and broadband bundles spread and make cable's installed base "stickier"

REDACTED – FOR PUBLIC INSPECTION

## Key Point #4: A Post-Merger Price Increase Based On Customer Class Or Location Is NOT a Plausible Outcome

- Both EchoStar and DIRECTV price their programming service on a national basis
- The commitment to a single national price serves to reinforce the current practice

REDACTED – FOR PUBLIC INSPECTION

# Key Point #4: A Post-Merger Price Increase Based On Customer Class Or Location Is NOT a Plausible Outcome

**A market test exists TODAY for whether EchoStar will take advantage of apparent opportunities to price discriminate by location on programming prices**

- EchoStar does <u>not</u> charge higher prices in areas where it competes with Pegasus even though Pegasus charges $4.50 more per month for the equivalent package
- Despite the higher price set by a supposedly rural provider, EchoStar has kept its programming price national and uniform
- Also, EchoStar and DIRECTV do not provide different commissions to retailers based on location

REDACTED – FOR PUBLIC INSPECTION

## Key Point #4: A Post-Merger Price Increase Based On Customer Class Or Location Is NOT a Plausible Outcome

- EchoStar customers gained through local promotions in the past have represented an exceedingly small share of the subscribers gained by EchoStar
- EchoStar and DIRECTV have not used localized promotions in a strategy to price discriminate

[

]

REDACTED – FOR PUBLIC INSPECTION

# Key Point #4: A Post-Merger Price Increase Based On Customer Class Or Location Is NOT a Plausible Outcome

## TARGETING CONSUMERS WITH NO ACCESS TO CABLE WOULD NOT BE PROFITABLE

It is difficult to identify the class of customers that are non-cabled

- For example, [ ] of people who left DIRECTV and who supposedly (according to the best available public data) live in areas without cable said they were switching to cable

It is difficult to target well-defined areas – even those that appear rural – that are without upgraded (digital) cable systems

- Approximately 80% of housing units in the bottom twenty DMAs are passed by digital cable

Without being able to accurately screen for those who do not have a cable alternative, price discrimination by New EchoStar would lead to a loss of profitable customers that DO have a cable alternative

REDACTED – FOR PUBLIC INSPECTION

# Key Point #4: A Post-Merger Price Increase Based On Customer Class Or Location Is NOT a Plausible Outcome

## RETAILERS WOULD NOT BE A CONDUIT FOR DISCRIMINATION

- Use of national retailers – who seek to sell their equipment in competition with cable – provides protection for consumers in seemingly non-cabled areas
- **National retailers** generally offer products at a uniform national price. The ubiquity of these retailers allows areas without cable to benefit from this uniform price
- Survey of **independent retailers** we conducted shows that the upfront DIRECTV equipment and installation price is the same in cabled and non-cabled areas. Competition from cable and national retailers drives consumer prices to equality across cabled and non-cabled regions

# Conclusions

- The merger will generate new and expanded DBS product offerings, such as local-into-local service in all 210 DMAs and more competitive satellite-based broadband service
- The merger will create consumer welfare benefits significantly in excess of $1 billion per year
- The merger will stimulate – rather than stifle – competition in the MVPD market
- New EchoStar has committed to pricing its product nationally, eliminating any residual concern about implausible price discrimination
- The merger is thus in the public interest

REDACTED – FOR PUBLIC INSPECTION